

Introduction

The two men did not much like each other, not that they had ever met. Personalities and politics ruled out a warm relationship. Neville Chamberlain, entering his fifth year as Britain's chancellor of the exchequer in 1936, was reserved by nature. He was more at ease watching birds or catching trout than shaking hands and slapping backs. But such was his skill that he ascended the political ladder all the same, from local council to Parliament, junior ministerial posts, and now to one of the great offices of state. Through hard work, mastery of detail, and preternatural self-confidence, he had become the dominant minister in Cabinet, a prime minister-in-waiting who often acted as if he already had the job. Chamberlain was sure his talents amply justified his influence and, as a result, did not handle dissent well. He treated those who saw the world differently than he with condescension, from members of Parliament at home to whole peoples abroad. The upstart Americans, seemingly too powerful for their own good, were a favorite target – “a nation of cads,” he complained.¹

Across the Atlantic, Chamberlain's counterpart, Secretary of the Treasury Henry Morgenthau, Jr., reached the halls of power in a less orthodox way. The son of a prosperous Jewish real estate mogul and ambassador, Morgenthau decided to strike his own path, buying a farm in the Hudson Valley in 1913. He soon became friends with his neighbor Franklin Roosevelt, and when the latter won election to the presidency two decades later, he brought Morgenthau to Washington, eventually installing him as the nation's top economic official. Given that Morgenthau's rise from farmer to chief financier depended entirely on a personal

¹ Neville to Hilda Chamberlain, February 4, 1933, in Chamberlain (2002, 374). This description builds on Parker (2002, chapter 1) and Self (2006, chapter 1).

relationship, he was sensitive to slights and instinctively suspicious, always on guard lest someone outmaneuver him. The financiers of London, with their reputation for cunning, were among those he most distrusted. He thus felt it best to keep Chamberlain, and the British generally, at a distance.²

This mutual distaste was at its strongest on matters of international monetary policy. As the Great Depression unfolded, both powers had shocked the world by leaving the gold standard. Yet they had done so at different times and in different ways. By 1936, neither trusted the other's currency policy, interpreting every move as an attempt to rig the international monetary system. Though the disputes could be arcane, emotions ran high. London viewed Washington's management of the dollar as ignorant and dangerous; Washington considered London's management of the pound selfish and destabilizing. The countries were locked in a monetary battle, one front of a larger monetary war convulsing the world in the 1930s. And the generals, Chamberlain and Morgenthau – finance ministers of the two most important economies – had no line of communication, so wary was each of the other.

But in the spring of 1936, with France headed toward a currency crisis, Morgenthau tried to put the past behind him and reach an understanding with London. He feared that French devaluation would unleash a new round of competitive depreciation and drag the world further down the abyss. It could worsen France's already fraught political situation and sow further discord between the democracies, all to the benefit of an increasingly aggressive Germany. To forestall these dangers, Morgenthau asked for permission from Roosevelt to open a dialogue with the British. Convincing the president took some persuading – Roosevelt exceeded Morgenthau in distrusting Chamberlain, sure that the latter “thoroughly dislikes Americans” – but Morgenthau eventually got the green light and sent out a feeler.³ Though Chamberlain was initially reluctant, he soon came around. A stream of cables commenced, first between the two capitals, then including Paris, working out the terms of a monetary truce. Over several months and in fits and starts, the finance ministers devised a plan whereby London and Washington would accept the franc's devaluation and not retaliate, preventing a renewed race to the bottom. In addition, all three countries would contribute to the “restoration of order in international

² Blum (1959) is the standard reference on Morgenthau.

³ Morgenthau conversation with Roosevelt, April 29, 1936, MD 22/155.

economic relations” by renouncing competitive depreciation generally and consulting on international monetary policy moving forward.⁴

Announced on September 26, 1936, the Tripartite Agreement, as it became known, offered the hope of a better future, one of cooperation rather than confrontation.⁵ “[T]he three great democracies,” *The New York Times* enthused, “have given evidence of their ability to work together in behalf of economic peace, recovery and order.” With the Agreement, “the world breathed a new hope. A streak of sunlight had broken through the dark clouds of nationalism.”⁶

Morgenthau was so pleased with the public’s reception that he informed a British representative of wanting one day to shake Chamberlain’s hand.⁷ The two had accomplished much, he thought, and could still do more. After hearing of Morgenthau’s gesture, Chamberlain, unable to take the compliment without a sneer, wrote to his sister, “I trust Providence will not put me to any such ordeal.” As it turned out, distance saved him from ever having to suffer Morgenthau’s handshake. But even Chamberlain was “glad to have produced such a change of heart” in Morgenthau and the Americans, claiming to have nudged them into a “more sympathetic mood” (Chamberlain’s pride would not let him admit that it was really Washington that had prodded London.)⁸

Friends, no, but the two men and their governments, as well as the French, could perhaps now be partners working toward a more stable monetary system. What was needed was trust. Slowly, the countries started to build confidence in one another. They began communicating as a matter of routine, discussing monetary developments and policies. While the Agreement, informal by design, did not bind countries to fixed exchange rates, the parties promised to intervene in markets to limit fluctuations and established new technical arrangements between central banks to facilitate these operations. Rather quickly, a monetary alliance took root.

⁴ See Appendix C for the text of the British statement and Bank for International Settlements (1937) for all of the statements.

⁵ The announcement occurred around 1 a.m. Paris time on September 26, which was still early evening on September 25 in Washington. This book dates the Agreement as having occurred on September 26 since Paris was the first to announce, but other sources date it as September 25.

⁶ “Toward Stabilization,” *The New York Times*, September 26, 1936; “Restoring Monetary Order,” *The New York Times*, October 4, 1936.

⁷ Mallet to Waley, September 29, 1936, T 160/840/7. The British representative reported that “Morgenthau was so delighted with the way things had gone that he became quite genial and human!”

⁸ Neville to Ida Chamberlain, October 10, 1936, in Chamberlain (2005, 210–11).

To a public yearning for good news, the Tripartite Agreement was a bright light, promising and captivating. For ministers and officials, it provided the backdrop to just about every issue of exchange rate policy, becoming the fundamental organizing principle of the international monetary system until the outbreak of the Second World War. At a time when little was going right, when relentless economic conflict seemed to be the natural order, the liberal powers – “rulers of the three master-currencies of the world” in the words of one City columnist – managed to defy the trend and find peace in their monetary relations.⁹

Yet, squeezed between the demise of the gold standard and the creation of the postwar monetary system, the Agreement is largely forgotten today. Few know of this pact that in many ways serves as the foundation of modern monetary cooperation; fewer still know how it worked. Research into the accord has been sparse. Save for a couple of works several decades ago, it usually receives a sentence at most, a paragraph on occasion, a page almost never.

Indeed, despite the centrality of the 1930s to monetary history, much of the decade’s story – not just that of the Tripartite Agreement – remains little known. Too often, the narrative peaks at the collapse of the gold standard and the fury over competitive depreciations and then ignores all that came after. But what came after was no less important. In fact, for most countries, the bulk of the decade was not pre- but post-collapse. Britain left the confines of the gold standard in 1931, the United States in 1933, France in 1936 (past the midpoint but still far from the end). Figuring out what to do in this chaotic situation was no easy task and went well beyond pushing exchange rates down. It was a time of trial and error, with the future of the global economy at stake. By not giving full weight to what happened after the breakdown of the gold standard, the conventional history oversimplifies the monetary war – portraying it as just a battle over exchange rates rather than a fight over the very design of the international monetary system – and disregards the peace. There is thus the need to reexamine the period to better understand how the former unfolded and how the latter emerged and operated. This book aims to do just that.

The 1930s was a time of immense deprivation. The statistics continue to astound. Production plummeted, trade evaporated, prices cratered,

⁹ “World’s Hopes from New Currency Compact,” *The Daily Telegraph*, October 7, 1936.

unemployment soared. The volume of global trade dropped nearly 30 percent from 1929 to 1932. The United States, which experienced one of the most devastating downturns, saw industrial production fall by almost 50 percent. Unemployment reached one in four. Britain's economy had not climbed as high as others in the 1920s so its crash in the 1930s was less precipitous. But its slump was nevertheless severe. Industrial production fell 17 percent, and unemployment hit one in six. Behind these raw numbers, people starved and anger mounted. While Britain, France, and America made it through without the collapse of society, elsewhere fascism took hold, further compounding the misery.

The Depression was not only grim: It was also incredibly disorienting for everyone living through it, monetary policymakers included. Events moved and ideas changed so rapidly that it was difficult to see straight. As a top official in the British Treasury lamented, "everything in the currency sphere has been kaleidoscopic," making what was clear one moment doubtful the next.¹⁰ To fight the Depression, countries threw off the chains of the gold standard, but then they wavered, unsure of the end goal and how best to get there. The old orthodoxy had lost its grip, but a new religion had yet to take hold. The result was a mishmash of monetary systems, no two precisely the same. Conflict filled the gaps as countries accused one another of distorting their currency policies. They fought not only over the movements of exchange rates – that is, the customary concern about competitive advantage – but also the flexibility of those rates, the connection between currencies and gold, the regulations surrounding gold, the freedom to deal in currencies, virtually every dimension of international monetary policy. Confusion was common, mercantilism ascendant, and confrontation frequent.

But there was also experimentation and innovation. However bewildering the moment, inaction was not a viable option – no politician could long survive in office doing nothing as people went without work and food. Governments had to design and execute policy, often with limited precedent to turn to. Britain, in particular, had little historical guidance with which to map its future after suspending gold convertibility – the promise to exchange currency for gold at a fixed rate – in September 1931. For centuries, sterling's gold value had been constant, except for times of war and its aftermath; suddenly that constraint vanished. The pound dropped 20 percent on impact against the dollar, franc, and other gold currencies, and was down 30 percent by the end of the year.

¹⁰ Hopkins, Untitled memo, May 25, 1937, T 177/39.

To better control sterling's movements, Britain devised one of the decade's key monetary inventions in 1932: the Exchange Equalisation Account (EEA). Endowed with assets of £171 million (4.1 percent of GDP) and ultimately growing to over £571 million (10.7 percent of GDP), the fund inaugurated a new era of exchange intervention, with governments actively managing their currencies in the market through the purchase and sale of foreign exchange and gold. At the same time, the EEA inflamed tensions around the world. Its statutory mandate of "checking undue fluctuations of the exchange value of sterling" left wide latitude, and many abroad viewed the secretive hoard as a weapon to depreciate the pound and gain a competitive advantage. America responded by establishing the Exchange Stabilization Fund (ESF) in 1934. The two funds blanketed both sides of the Atlantic in a haze of suspicion. All the while, France, seeking salvation in purity, clung to gold, blaming Anglo-American heretics for its economic plight.

Bitterness and rivalry seemed to be the order of the day until the most important innovation of all: the Tripartite Agreement. Through it, France, conceding to the inevitable, left the gold standard but did so in a way that, far from poisoning relations, drastically improved them. Under the Agreement, rather than protest or retaliate, London and Washington "welcomed" France's decision. Though the arrangement was not a treaty or even a single text – each nation issued its own virtually identical five-paragraph statement – the parties indicated their commitment moving forward to avoid competitive depreciation and exchange control, as well as to work toward easing restrictions on trade. The aim was to achieve "the greatest possible equilibrium in the system of international exchanges," while reserving the right always to "take into full account the requirements of internal prosperity." That is, the countries would no longer act without regard to the impact on others, but neither would they return to a system, such as the gold standard, that required sacrificing the domestic economy at the altar of fixed exchange rates.

Among the many consequences of this entente was a revamping of technical arrangements between the members. Now working in concert, exchange managers were to use their funds to dampen currency fluctuations. But doing so was more complicated than simply buying and selling foreign exchange. Precisely because currencies were no longer fastened to gold, managers did not want foreign exchange on their balance sheets. If a currency depreciated, the fund could take a hit: better to hold gold, which seemed unlikely ever to lose value. To reconcile the need to intervene with the insistence on holding reserves in gold, the Tripartite

countries developed a new structure of reciprocal gold facilities, whereby they exchanged their currencies for gold with one another on a daily basis. Britain, for example, would now give gold to France in return for any pounds the latter purchased even though Britain no longer had any legal obligation to convert sterling into gold. This “24-hour gold standard” was a hallmark of the Tripartite years. Besides stitching together the members’ disparate monetary systems, this “new type of gold standard,” as Morgenthau called it, demonstrated the continued pull of the past: The old gold standard was dead, but the metal remained indispensable.¹¹

In November 1936, Belgium, the Netherlands, and Switzerland joined the “currency club.” Though “junior members” in the eyes of the founders, smaller influence befitting smaller economies, the club’s expansion provided further proof that a corner had been turned.¹² This new cordiality, however, was not universal. Not every country belonged to the club, most notably, Germany, Italy, Japan, and Russia.¹³ Their exclusion was on purpose. Part of the motivation behind the Tripartite Agreement was to strengthen the liberal order of free exchange against the proliferation of exchange controls – regulations that governments imposed to restrict transactions in foreign currencies – which the democracies deemed totalitarian. Since Berlin, Rome, Tokyo, and Moscow relied on these methods, their membership would have been incongruous at best. In addition, the Agreement was a tool to unify the democratic powers and demonstrate their resolve to friend and foe alike. A primary motivation for the pact was, its preamble declared, to “safeguard peace.” Though London, always trying to keep open the possibility of appeasement, was more hesitant than Paris and Washington in ascribing overtly political intentions to the Agreement, it grew to view the club as an instrument to bring the democracies closer together. The Tripartite Agreement thus became, to its members, the public, and the world, a measure of and force for democratic cooperation.

All of this is to say that the collapse of the gold standard was more than the end of an era: It was just as much the beginning of another. This book picks up the baton, considering what happened after the fall. Three themes ground the narrative. First, understanding why the democratic powers locked horns during the early years of the decade requires looking beyond charts of the pound, dollar, and franc. The monetary war encompassed far

¹¹ Press conference, October 12, 1936, MD 39/34.

¹² See, for instance, Simon to Morgenthau, July 19, 1937, BoE C43/327.

¹³ See Chapter 8, however, for the various attempts to bring some of these countries into the fold.

more than a disagreement over the level of exchange rates: It involved all aspects of currency management. For instance, Paris and Washington were to some extent less concerned with the pound's initial depreciation in 1931 than with London's refusal to return to the gold standard and reestablish a fixed rate quickly thereafter. When the Americans left the gold standard in 1933, they did so over a chaotic, drawn-out period, throwing Europe off-balance to a far greater degree than had a clean, one-time devaluation occurred. The way in which Roosevelt devalued, not just the fact that he did, helps explain why relations soured. London and Washington also refused to share information on exchange intervention, leading each to assume that the other was up to no good with their funds. None of these points negate the predominant role of exchange rates, but grasping the full extent of the conflict requires examining each dimension on which it played out. It then becomes clear why tensions remained so high for so long, even during times when countries were generally satisfied with the level of exchange rates.

Second, the Tripartite Agreement was a watershed, fundamentally altering monetary relations. The members pivoted from fighting over their fiercest disagreements to finding areas of consensus on which they could build. Though they differed as to whether exchange rates should be fixed, they all believed that less volatility was better than more, so they set up a system to enable stabilizing intervention through reciprocal gold facilities. Exchange funds, previously suspect, now embodied the new collaborative spirit. Members talked constantly, detailing their actions, getting advice, and coordinating efforts – gone were the days when London and Washington guarded information on intervention from each other as a state secret. The Agreement provided the framework through which all issues of international monetary policy were considered, by both policymakers and the public. As Sir Frederick Leith-Ross, one of Britain's top financial diplomats, recalled, it was “the basis of our currency policy.”¹⁴

To be sure, the Tripartite Agreement was not perfect. It was limited by design, leaving many problems unsolved. None of the members were willing to lend to one another, meaning that there was no long-term support for balance of payments problems. Officials, ministers, and observers wondered at times exactly what the Agreement required given its purposeful ambiguity, and more than a few crises tested its viability, particularly repeated problems with the franc. But there is no question

¹⁴ Leith-Ross (1968, 170).

that it marked a momentous shift. Countries no longer viewed the international monetary system as an arena in which to fight for maximum advantage but as a structure that needed to be upheld for the benefit of all.

Finally, giving the Tripartite system its due sheds light on the evolution of the international monetary system, particularly the role of gold. Monetary systems are not binary: They exist on a continuum. The breakdown of the gold standard did not mean the end of gold's influence; in fact, it solidified the metal's preeminence as a reserve asset among the democratic powers. Many central banks had held foreign exchange on their balance sheets in the 1920s and the beginning of the 1930s when the gold standard was in operation. They then suffered enormous losses on these assets as the system disintegrated and currencies depreciated during the first half of the 1930s. As a result, monetary authorities rebalanced their portfolios away from foreign exchange and toward gold. The irony, then, was that when the gold standard was credible, foreign exchange was an acceptable reserve asset; once the gold standard fell apart, only gold seemed safe.¹⁵ Studying the evolving principles of foreign exchange management, including the first in-depth analysis of the reciprocal gold facilities, brings these considerations into relief and helps bridge the gap in the literature between the end of the gold standard and the birth of the postwar system at Bretton Woods.

What follows then is a story about international monetary policy and relations in the wake of the gold standard's collapse. It examines the triangle joining London, Paris, and Washington (with some branching out to Amsterdam, Berne, and Brussels), looking at why the connections frayed and how, with the Tripartite Agreement, they became stronger than ever. Though all three sides are integral to this history, the emphasis is on the London–Washington link. It suffered the greatest strain at the decade's beginning, nearly snapping in half from the pressure, but went on to mend and rejuvenate during the Tripartite years. Indeed, the Anglo-American relationship formed the backbone of the currency club.

And while this book is international in scope, it focuses on Britain's management of the pound to structure the narrative. There are many reasons for doing so. As the first major country to depreciate and suspend

¹⁵ This dynamic applied to countries with key currencies, the focus of this book. There was an opposite tendency to move away from gold and toward foreign exchange for smaller countries whose economies were closely connected to larger trading partners. For instance, much of the British Empire, as well as Scandinavia and some other countries, pegged to sterling and turned most of their reserves into sterling. See Chapter 3 for more on what became known as the Sterling Area.

gold convertibility, Britain launched the era that this book seeks to explain. The Bank of England (BoE), exhorted on by the Treasury, lowered its policy rate to 2 percent in the summer of 1932 in pursuit of a “cheap money” program and kept it there for an unprecedented seven years until the outbreak of war. With this policy lever pushed to and held at an all-time low, exchange rate management became the dominant day-to-day and month-to-month concern. The EEA thus turned into Britain’s main monetary policy instrument. Records of its operations – the longest available since it predated other funds by several years – provide a window into the changing strategies of exchange managers and the ups and downs of international monetary relations. Sterling was also a linchpin of the international monetary system, with roughly one-fifth of the world’s population living in a country that either used sterling or pegged to it.¹⁶ Finally, though there has been brilliant work on various aspects of Britain’s story – Howson (1980) on the EEA, Sayers (1976) on the BoE, Drummond (1979, 1981) on the relationship with America, all of which provide the foundation for this book – it has yet to be told in full. London, then, is the ideal vantage point from which to explore the new monetary world of the 1930s.

The literature on the Great Depression is vast, and monetary policy plays an important role in any economic history of the period. Of course, it is a largely ignominious role. As Ahamed (2009, 7) writes, central bankers of the leading powers – the “lords of finance” – “broke the world” by forcing it into the “straitjacket” of the gold standard in the aftermath of the First World War. Under their stewardship, countries pegged their currencies to gold and thereby to one another, bringing about, by the end of the 1920s, a system of fixed rates. But as the downturn set in, the gold standard became a trap. The first rule of the gold standard was to maintain the peg, which meant keeping interest rates high enough to prevent gold from flowing out. The perverse result was that, even as economic prospects worsened, monetary authorities fought to attract gold, raising interest rates. Friedman and Schwartz (1963) show how in the United States the collapse in money supply brought about a grinding deflation that debilitated the economy, a story played out to varying degrees around the world.¹⁷

¹⁶ Aldcroft (2004, 35).

¹⁷ Eichengreen (1992) provides an invaluable panoramic view of the interwar monetary system. Country-specific studies include: for Britain, Drummond (1981), Howson (1975), and Sayers (1976); for the United States, Chandler (1971), Friedman and Schwartz